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How New Bankruptcy Code Changes Affect Tenants

On April 20, 2005, President Bush signed the *Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, which makes some significant changes to the U.S. Bankruptcy Code related to commercial real estate. Most of those changes are favorable to shopping center and office building owners and unfavorable to tenants. There are six key changes in particular that you should know about because they could have a big impact on you if you ever file for bankruptcy, say Maryland bankruptcy attorney Michael J. Lichtenstein and New Jersey real estate/bankruptcy attorney David J. Rabinowitz.

Most of the new law's provisions, including those discussed in this article, go into effect on Oct. 17, 2005, although some apply now to all new bankruptcy filings.

Here's a rundown on the new law's six key changes (starting with those that favor owners and ending with those that could help you):

Ends Unlimited Extensions of Deadline to Assume/Reject Lease

If you ever must file for bankruptcy, you must decide whether to assume or reject your lease, says Rabinowitz. If you assume your lease, you must cure any lease violations and continue to honor your lease obligations, including paying rent, he explains. Or you can seek to assign your lease to another tenant. If you reject your lease, you must move out of your space, he adds.

In the past, the Bankruptcy Code gave you, as a debtor, an initial 60-day period to make the decision to assume or reject a lease, says Rabinowitz. But 60 days often wasn't enough time to make an informed decision, and debtors typically requested the bankruptcy court to grant extensions of the deadline. Many owners complained that bankruptcy courts granted too many extensions, stretching out the deadline for years. The new law responds to those complaints by setting a firm deadline

by which you must decide whether to assume or reject your lease, says Rabinowitz. Now, you have 120 days to make a decision, he says. If you need more time, you can request only one 90-day extension "for cause" (although that term isn't defined). Any further extensions must be approved by the owner, in writing, Rabinowitz notes. So you now have a maximum of only 210 days to decide what to do with your leases.

Strengthens Limits on Lease Assignments that Disrupt Tenant Mix

The Bankruptcy Code gives shopping center owners specific protections regarding the assignment of leases, says Rabinowitz. One key protection requires the assignee of a bankrupt tenant's lease to be bound by the lease's clauses—including the use clause—so it can't disrupt the center's tenant mix, he notes. So, in theory, if you're a bankrupt clothing store tenant, the owner can block you from

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assigning your lease to, say, a hardware store, Rabinowitz notes. But in the past, the Bankruptcy Code also gave bankruptcy courts the right to strike any "anti-assignment" clauses—including the use clause—from your lease. That made it easier for you to get around the shopping center owners' protections and find an assignee, he says.

Shopping center owners complained that the bankruptcy courts were undermining their protections and disrupting their tenant mix, says Rabinowitz. The new law appears to give owners' protections priority over the bankruptcy courts' right to strike any anti-assignment clauses in a bankrupt tenant's lease, he says. In essence, the new law requires your proposed assignee to comply with the lease's use clause, giving the owner more control over your lease assignment and making it harder for you to find an acceptable assignee, explains Lichtenstein.

Ends Unlimited Deadline Extensions for Filing 'Plan of Reorganization'

If you reject your lease, the owner will have what's called an "unsecured claim" for the rent due, subject to a cap for rejections claims. That cap is equal to the greater of one year's rent or 15 percent of the remaining rent, not to exceed three years' rent, notes Lichtenstein. With this kind of claim, if you've filed for bankruptcy under Chapter 11 of the Bankruptcy Code, the owner must wait to get paid until your "plan of reorganization" is final and confirmed by the court.

In the past, you had the exclusive right to file a plan of reorganization within the first four months of your bankruptcy case. During that "exclusive right" period, neither the owner

nor any other creditor was allowed to file a plan of reorganization on your behalf to speed up the reorganization process. To give you more time to create the plan, bankruptcy courts typically would extend the length of that exclusive right period.

Owners complained that they had to wait years for the plan of reorganization to become final and confirmed, notes Lichtenstein. To cut down on the waiting, the new law sets a firm deadline for you to file your plan of reorganization. That is, you've got the exclusive right to file a plan only within 18 months of your bankruptcy filing—and a court can't extend that period, he says. If you haven't filed a plan by that time, the owner or another creditor can file one on your behalf, so that it can get its claims paid faster.

Lets Owner Win 'Ordinary Course of Business' Argument More Easily

In the past, it was easier for you or your bankruptcy trustee to get back any rent that you paid to an owner within three months before you filed for bankruptcy, says Lichtenstein. You or the bankruptcy trustee simply had to claim that the owner was unfairly given preferential payment treatment over your other creditors. If the owner wanted to keep the rent, it had to argue that you paid the rent in the "ordinary course of business"—which was difficult to prove, he notes.

You or the bankruptcy trustee can still claim the owner got preferential payment treatment in this situation. But the new law makes it easier for an owner to prove that your payments to it were made in the ordinary course of business. This gives the owner a better chance of keeping rent paid within three months of your bankruptcy filing, says Lichtenstein. If you can't get

back that rent, you'll have less money to pay off your other creditors.

Allows You to Cure Nonmonetary Lease Defaults

The Bankruptcy Code requires you to cure all lease defaults if you assume your lease, says Rabinowitz. But in the past, some bankruptcy courts ruled that when the default was nonmonetary—such as your failure to continuously operate—you couldn't cure the default. Such a ruling could prevent you from assuming your lease, even if the owner wanted you to do so, he points out.

The new law recognizes that it's unfair to prevent you from assuming a lease in that situation. So it says that if your nonmonetary lease default is failing to continuously operate, you can cure that default by resuming operations when you assume your lease, says Rabinowitz. But you're still required to pay the owner any damages resulting from your failure to continuously operate, he adds.

Caps Owner's Administrative Claim

The Bankruptcy Code allows you to assume your lease after you've filed for bankruptcy, then later decide to reject it. In the past, in that situation, the Bankruptcy Code let owners make an "administrative claim" for the rent (and any other payments, excluding penalty payments) that would have been due if you hadn't later decided to reject the lease. (An administrative claim would entitle the owner to "100 cents on the dollar" for each dollar of rent you owed, Lichtenstein explains. It's generally also paid before other claims.) So, for example, if you rejected your lease with five years remaining on its term, the owner could have made an administrative claim for five years of rent.

The new law imposes a cap on the amount of the owner's administrative claim in this situation, says Lichtenstein. It says that if, at the time you reject the lease, two or more years remain on its term, the owner can't make an administrative claim for more than *two years* of rent (and any other payments, excluding penalty

payments). So, for example, if you reject your lease when five years remain on the lease term, the owner can make an administrative claim for only two years of rent. The rest of the unpaid rent becomes an unsecured claim, paid later than administrative claims, and is subject to the cap on rejection claims. So you'll have more

money available to pay off your other creditors. ■

Insider Sources

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